BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the **Matter** of the Appeal of)
)
PUP **'n'** TACO DRIVE UP)

For Appellant: Robert P. Rice
Certified Public Accountant

For Respondent: James W. Hamilton
Acting Chief Counsel

Steven S. Bronson
Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Pup **'n'** Taco Drive Up against proposed assessments of additional franchise tax in the amounts of **$1,676.12, $1,894.64, $2,105.73** and **$1,357.00** for the income years 1969, 1970, **1971** and 1972, respectively.

Appeal of Pup 'n' Taco Drive Up

The sole. issue is whether appellant Pup 'n' Taco' Drive Up was engaged in a unitary business with two partnerships located outside California. Several other issues raised at the protest level have not been argued before this board, and we therefore assume they have been abandoned or conceded.

Appellant was incorporated in California on May 10, 1965. Since then its principal business activities have been franchising and operating fast-food restaurants. By 1968 it had 18 restaurants, most of which were located in Los Angeles and Orange Counties. In that year appellant decided to expand beyond California, and it therefore leased property and contracted for equipment to establish a Pup 'n' Taco Drive Up in Albuquerque, New Mexico (hereinafter sometimes referred to as the "Albuquerque Drive Up") Since appellant did not have sufficient organization or management staff to carry out this expansion within the company, it planned to operate the Albuquerque Drive Up as a partnership rather than as a part of the corporation.

In May 1968 appellant entered into a partnership. agreement with Martin R. Wendell, a brother of appellant's president. The agreement provided that appellant would own a 52 percentinterest and Wendell would own a 48 percent interest in the Albuquerque Drive Up. Wendell was to serve as the new restaurant's manager, subject to appellant's direction and control, but appellant was authorized to remove him as manager at any time for cause. Failure to follow appellant's instructions was specifically described as cause for removal. As one condition of the agreement appellant promised to make interest-free loans to the partnership, if needed, and also to arrange for and guarantee a line of credit with suppliers. The agreement also directed the partnership to keep its books in a manner directed by an accountant to be selected by appellant. In addition, appellant granted the partnership a license to use the name 'Pup 'n' Taco Drive Up #24." Appellant retained all ownership rights in the name, however, and was to receive royalties for the partnership's use of its name and system of operation.

The architectural style and operational system of appellant's California restaurants served as a prototype for the Albuquerque Drive Up. Twenty of the thirty items appearing on appellant's menus were included on the Albuquerque menu, although the prices of some of those items were different. In addition some of the menu items were prepared with a secret and distinctive blend of spices which appellant and the Albuquerque Drive Up purchased in common from a supplier in Chicago. Apparently appellant seldom if ever took an active role in the day-to-day operation of the partnership, including such matters as the hiring of employees and the purchasing of supplies other than spices, but appellant's accounting firm did conduct periodic audits of the partnership's books to insure that such matters were being handled efficiently.

In 1972 appellant entered into a partnership agreement to operate a Pup 'n' Taco Drive Up in Denver, Colorado (hereinafter sometimes referred to as the "Denver Drive Up".) The record does not reveal the terms and conditions of this agreement. Respondent alleges, however, and appellant appears to concede, that the business of the Denver Drive Up was conducted similarly to that of the Albuquerque Drive Up.

Appellant used a separate accounting method to compute its California income on its franchise tax returns for the income years in question. After an audit, respondent determined that appellant and the two partnerships were engaged in a single unitary business. It therefore recomputed appellant's California income using the formula apportionment provisions of the Uniform Division of Income for Tax Purposes Act, Revenue and Taxation Code sections 25120 through 25139. This action resulted in the proposed assessments at issue.

The California Supreme Court has held that a business is unitary where the following factors are present: (1) unity of ownership; (2) unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) unity of use in a centralized executive force and general system of operation. (Butler Brothers v. McColgan, 17 Cal. 2d 664, 678 [111 P.2d 334](1941), aff'd 315 U.S. 501 [86 L. Ed.

991](1942).) The court has also stated that a business is unitary when the operation of the business within California contributes to or is dependent upon the operation of the business outside the state. (Edison California Stores v. McColgan, 30 Cal. 2d 472, 48183 P.2d 16](1947).) "It is only if [a foreign corporation's] business within this state is truly separate and distinct from its business without this state, so that the segregation of income may be made clearly and accurately, that the separate accounting method may properly be used." (Butler Brothers v. McColgan, supra, 17 Cal. 2d at 667-668.) These general principles have been reaffirmed in several more recent cases. (Superior Oil Co. v. Franchise Tax Bd., 60 Cal. 2d 406 [34 Cal. Rptr. 545, 386 P.2d 33](1963); Honolulu Oil Corp. v. Franchise Tax Bd., 60 Cal. 2d 417 [34 Cal. Rptr. 552, 386 P.2d 40](1963); RKO Teleradio Pictures, Inc., v. Franchise-Tax Board, 246 Cal. App. 2d 812 [55 Cal. Rptr. 299](1966).)

Since appellant owns a 52 percent interest in the Denver and Albuquerque partnerships, the unity of ownership requirement is satisfied. (See Appeal of Signal Oil and Gas Co., etc., Cal. St. Bd. of Equal., Sept. 14, 1970.) Unity or use is also present since appellant establishes overall policy for the business, as evidenced by the fact that the partnerships' managers are subject to dismissal for failure to follow appellant's instructions. (See Chase Brass & Copper Co. v. Franchise Tax Bd., 10 Cal. App. 3d 496, 504 [87 Cal. Rptr. 239](1970).) Unitv of operation is evidenced by the use of a single trade name and system of operation, similar architectural styles and menus, common purchasing of distinctive spices, and the use of appellant's accounting firm to conduct periodic audits of the partnerships. Moreover, appellant leased property for the partnerships, offered them interest-free loans; and arranged for and guaranteed lines of credit. The infusion of capital, knowledge and business reputation into the partnerships presumably contributed greatly to their success. Taken together, these circumstances establish that appellant and the partnerships are a unitary business, despite the alleged autonomy in their day-to-day operations. (See Appeals of Servomation Corp., et al., Cal. St. Bd. of Equal., July 7, 1967; Appeals of Simonds Saw and Steel Co., et al. Cal. St. Bd. of Equal., Dec. 12, 1967; Appeal of F. W. Woolworth Co., Cal. St. Bd. of Equal., July 31, 1972.) We so hold.

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Pup **'n'** Taco Drive Up against proposed assessments of additional franchise tax in the amounts of **$1,676.12, $1,894.64, $2,105.73** and **$1,357.00** for the income years 1969, 1970, 1971 and 1972, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 2nd day of March, 1977, by the State Board of Equalization.

_____, **Chairman**

_____, **Member**

_____, **Member**

_____, Member

_____, Member

ATTEST: _____, Executive Secretary